Regulatory Circular C2 RG11-017

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| To: | Trading Permit Holders and<br>Clearing Trading Permit Holders |
| From: | Division of Registration and Regulatory Services |
| Date: | September 23, 2011 |
| Subject: | Margin and Net Capital Requirements<br>- PM Settled Options on The S&P 500 Index (SPXpm) |

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## KEY POINTS

- On October 4, 2011, C2 will begin trading SPXpm, a PM-settled, European-exercise option class on the S&P 500 Index.

- Spread margin treatment, pursuant to current strategy-based margin rules, is available for spreads mixing SPXpm and SPX options, except that spread margin treatment may **not** be applied to spreads involving a long SPX option and a short SPXpm option that have the same expiration date.

- SPXpm calls may be written in a margin account against an equivalent long position in the S&P 500 Depositary Receipts exchange traded fund ("SPY") and receive covered call treatment, as is currently permitted for SPX calls under Regulatory Circular RG99-09. However, a broker-dealer must have policies and procedures in place to permit this treatment.

- Detailed product specifications may be found on the CBOE website at the following URL: http://www.cboe.com/micro/spxpm/default.aspx

## DISCUSSION

CUSTOMER MARGIN

With certain exceptions, customer strategy-based margin requirements for SPXpm options are the same as for SPX options. One exception pertains to spread margin treatment. Two-legged spreads involving SPXpm and SPX options are permitted. However, when the SPXpm and SPX options composing a spread have the same expiration date and the long component of the spread is an SPX option(s), spread margin treatment is **not** permitted. This is because a long SPX option is AM settled, effectively leaving a short SPXpm with the same expiration uncovered for the remainder of the day. Therefore, a co-existing long SPX option and short SPXpm option with the same expiration date must be margined separately as a long option and an uncovered short option. Note that a mixed spread that is eligible for spread margin treatment (a long SPXpm option and a short SPX option that have the same expiration date) is, in effect, a calendar spread.

In addition, conversions, reverse conversions and collars that mix SPXpm and SPX options are not eligible for the maintenance margin requirements permitted under CBOE rules. If SPXpm and SPX options were mixed to imitate a box spread, such box spread would not be eligible for box spread margin requirements permitted under CBOE rules.

Under Exchange rules, complex spreads; such as butterfly, iron butterfly, condor and iron condor; that are composed of cash-settled, European-style index options must have the same expiration date. As with two-legged spreads (when all components have the same expiration date) a SPX option may not be a long component in a complex spread. Note that, if a complex spread is composed of long SPXpm options and short SPX options, it also takes on calendar spread characteristics.

In respect of calendar spreads, trading permit holder organizations are reminded that SPXpm and SPX options are European style. It is possible that the spread margin requirement could be, or become, insufficient to cover the assignment obligation on the short option if the long option cannot be exercised and it is trading at less than its intrinsic value in relation to the price of the current index value that determines the intrinsic value of the short option. Therefore, member organizations must apply “house” margin requirement policies and procedures for calendar spreads with European style options in order to insure that sufficient margin is held to cover the risk.

Short straddles and combinations mixing SPXpm and SPX options are permitted, with the margin requirement being the same as it is now for SPX short straddles and combinations.

SPXpm calls may be written in a margin account against an equivalent long position in the S&P 500 Depositary Receipts exchange traded fund and receive covered call treatment, as is currently permitted for SPX calls under Regulatory Circular RG99-09.[1] However, a broker-dealer must have policies and procedures in place to permit this treatment.

SPXpm options are eligible for portfolio margining and will be included in the same product group as SPX options. The portfolio margin requirement will be equal to the maximum potential loss over a range of market movements covering -8%/+6%. SPXpm options will have a 100% offset with SPX options, a 90% offset with other classes in the product group and a 50% offset with the NASD and Small Cap. Indices product groups. All positions are subject to a minimum charge of $37.50 per contract, except that the minimum charge for long options will not exceed the market value. These requirements are Exchange minimums. House portfolio margin requirements may be greater.

OPTION MARKET–MAKER MARGIN REQUIREMENTS

Pursuant to CBOE Rule 12.3(f), SPXpm option positions of a SPXpm options market-maker may be margined on a basis that is satisfactory to the market-maker and carrying broker-dealer.

[1] SPXpm calls may also be written in a margin account against an equivalent long position in the iShares S&P 500 exchange traded fund (“IVV”) and receive covered call treatment, as is currently permitted for SPX calls under Regulatory Circular RG02-110. However, a broker-dealer must have policies and procedures in place to permit this treatment.

SPXpm option positions of a SPXpm options market-maker are eligible for cross-margin treatment in a cross-margin account carried for the options market-maker by a clearing trading permit holder. Proprietary SPXpm option positions of OCC clearing members are also eligible for cross-margining. The cross-margin account must be a futures account and must be used exclusively for the CBOE/CME/OCC cross-margin program. The SPAN file will be set to take any risk offsets between SPXpm options and any positions in other eligible products in the cross-margin account into consideration and render a margin requirement accordingly. Additionally, a risk-based haircut (“RBH”) must be computed on the cross-margin account positions. If the RBH is greater than the SPAN margin requirement, the RBH must be used as the margin requirement in lieu of the SPAN margin requirement.

Questions regarding the margin treatment of SPXpm options should be directed to James Adams, Department of Member Firm Regulation, at (312) 786–7718.

## NET CAPITAL REQUIREMENTS

For risk-based haircuts, SPXpm options will be included in the same product group as SPX options.[2] The risk-based haircut will be equal to the maximum potential loss over a range of market movements covering -8%/+6% in the case of options market-makers, and +/-10% in the case of all other broker-dealers. SPXpm options will have a 100% offset with SPX options, a 90% offset with other classes in the product group and a 50% offset with the NASD and Small Cap. Indices product groups. All positions are subject to a minimum charge of $25.00 per contract, except that the minimum charge for long options will not exceed the market value.

For those firms not utilizing risk–based haircuts, the haircut will be calculated pursuant to the alternative strategy based method of SEC Rule 15c3–1a.

Questions regarding the net capital treatment of SPXpm options should be directed to Robert Gardner, Department of Member Firm Regulation, at (312) 786–7937.

[2] Risk–based haircuts may be applied pursuant to SEC Rule 15c3-1a (Appendix A).